

**Appropriate Changes Were Made to Tax
Products; However, Improvements Are
Needed for Tracking the Changes**

May 2002

Reference Number: 2002-40-090

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

May 7, 2002

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

A handwritten signature in cursive script, reading "Pamela J. Gardiner".

FROM: Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Final Audit Report - Appropriate Changes Were Made to Tax Products; However, Improvements Are Needed for Tracking the Changes (Audit # 200140050)

This report presents the results of our review to determine if tax forms, instructions, and publications (tax products) for Tax Year (TY) 2001 reflect the tax law changes from the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA 2001).¹ We focused our tests on changes for the income tax rate reduction (rate reduction) and child tax credit provisions of the EGTRRA 2001.

We found that in spite of the short time frame for making changes, the IRS did a good job revising the 39 tax products we selected for review to reflect changes to the rate reduction and child tax credits resulting from the EGTRRA 2001. The IRS also took immediate action to correct an error we identified during our review. However, controls need to be improved to properly track changes being made to tax products. The current tools used to track the changes are incomplete. By not properly updating the tracking tools, the IRS does not have reliable information to ensure that tax products affected by new tax laws are identified, revised, and printed in time for the filing season.

A prior Treasury Inspector General for Tax Administration audit report² issued in March 2000 identified this same issue. In response to that report, the IRS stated it would devote the necessary resources to ensure that internal controls are used to ensure the efficiency and effectiveness of the tax forms development process.

¹ Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38 (2001).

² *The Process of Developing Tax Forms for Individual Taxpayers Should Be Further Improved* (Reference Number 2000-40-060, dated March 2000).

Management's Response: Although the IRS was not required to respond to this report, IRS management did provide a response. In this response, they agreed with the report and its finding and stated that they are taking steps to more closely monitor changes to tax products. Management's complete response to the draft report is included as Appendix V.

Please contact me at (202) 622-6510 if you have questions or Michael R. Phillips, Assistant Inspector General for Audit (Wage and Investment Income Programs), at (202) 927-0597.

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**Appropriate Changes Were Made to Tax Products;
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Background

Viewed as the largest tax cut since 1981, the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA 2001)¹ became public law on June 7, 2001, and introduced many changes that affect individual taxpayers.² Some of the changes include cuts in income tax rates (rate reduction) and increases in the child tax credit amount from \$500 to \$600 per qualifying child. These changes will occur throughout the next 10 years.

For Tax Year (TY) 2001, the rate reduction and child tax credit provisions could affect approximately 122 million individual taxpayers. The rate reduction provision reduced individual tax rates 1 percent in each tax bracket except the 15 percent tax bracket. However, the tax rates were reduced by only one-half of 1 percent for TY 2001 since the law became effective in July 2001.

Reduction in Income Tax Rates for TY 2001

TY 2000 Tax Rates	TY 2001 Tax Rates
15.0 %	15.0 %
28.0 %	27.5 %
31.0 %	30.5 %
36.0 %	35.5 %
39.6 %	39.1 %

Source: Commerce Clearing House 2001 Tax Legislation: Law, Explanation, and Analysis—Economic Growth and Tax Relief Reconciliation Act of 2001.

The rate reduction provision also created a new 10 percent tax bracket for TY 2001, but it was replaced by an advance payment to taxpayers based on their TY 2000 income tax returns. The advance payment is commonly referred to as a rebate. Taxpayers who did not receive an advance payment, or received less than the maximum amount of the rate

¹ Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38 (2001).

² Individual taxpayers are non-business taxpayers who file United States (U.S.) Individual Income Tax Returns (Forms 1040, 1040A, or 1040EZ).

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reduction credit, may complete a worksheet in their TY 2001 income tax package to determine if they can claim this credit on their TY 2001 income tax return. A new line was added to the U.S. Individual Tax Returns to claim any additional rate reduction credit.

Each year, the Internal Revenue Service (IRS) must revise its tax forms, instructions, and publications (tax products) to reflect changes resulting from tax laws that are passed. The two IRS functions primarily responsible for revising and printing these tax products are the Tax Forms and Publications and Multimedia Publishing Divisions.³ The Office of Tax Administration Coordination (OTAC) is responsible for the overall implementation of the EGTRRA 2001.

The revision process begins in the Tax Forms and Publications Division. Tax products that need revising are assigned to a Tax Law Specialist (TLS). Each TLS is responsible for interpreting the tax law, determining what changes are needed, and making the required changes for the tax products assigned to him or her. After the changes are made, the TLS circulates the tax products to internal reviewers for approval. The TLS also circulates the tax products to the Tax Forms Coordinating Committee (TFCC) for review and approval. The TFCC consists of representatives from various IRS functions. The role of the TFCC is to review tax forms, suggest changes, and identify errors before the tax forms are approved for printing.

IRS personnel from both divisions (Tax Forms and Publications and Multimedia Publishing) meet and agree on a date the tax products are ready for printing.

The Multimedia Publishing Division is responsible for sending tax products to the printing contractors. After the tax products are printed, personnel from the Multimedia Publishing Division arrange to have the tax products shipped to the various post offices, libraries, and IRS locations for distribution to taxpayers. The revised tax

³ Both functions are in the IRS Wage and Investment Division.

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products are also placed on the IRS' public Internet website for use by taxpayers.

Both divisions use tracking tools that show the movement of the tax products through the revision process. The Tax Forms and Publications Division uses the Program Chart and the Multimedia Publishing Division uses the Milestones Production Schedule. These tools include target and actual completion dates for key steps that must be completed to ensure the revised tax products will be ready for the filing season. Some of the key steps include reviewing the products to ensure required revisions have been made and approving the products for printing. Employees in both divisions are responsible for updating these tools as each key step in the revision process is completed.

The OTAC uses the Legislative Implementation Tracking System (LITS) to track the implementation of enacted legislation (this is the IRS' main tracking tool). The LITS includes an action plan that shows all actions required to implement the law, the due dates for completing the items, and the status of the action items. All functions affected by new legislation are required to submit their action plan to the OTAC for inclusion on the LITS for monitoring purposes. The functions make monthly updates and risk assessments on the LITS. At the time of our review, the LITS contained 77 tax products, including 51 tax products that are used by individual taxpayers.

The audit was conducted in the Tax Forms and Publications and Multimedia Publishing Divisions in the IRS' National Headquarters between July 2001 and January 2002. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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**Tax Products We Reviewed
Were Revised to Reflect
Changes From the New Tax
Law**

We reviewed 39 of the 51 tax products on the LITS that are used by individual taxpayers to determine the status of revisions. We determined that the IRS did a good job revising the 39 tax products to reflect the changes from the new tax law.⁴ Some of the revisions made to the tax products were as follows:

- A new line item was added to the family of U.S. Individual Income Tax Returns (Form 1040, Form 1040A, and Form 1040 EZ) to allow taxpayers to claim the additional rate reduction credit.
- The income tax rates were reduced to 27.5, 30.5, 35.5, and 39.1 percent in the instructions for the Form 1040 family of returns, the U.S. Tax Guide for Aliens (Publication 519), and the Older Americans' Tax Guide (Publication 554).
- The backup withholding rate was reduced to 30 percent in the Instructions for Dividends and Distributions (Form 1099-DIV).
- The child tax credit amount was increased to \$600 per qualifying child in the Child Tax Credit publication (Publication 972).

See Appendix IV for a list of the 39 tax products we reviewed.

**The IRS corrected an error we identified on a
Spanish-language worksheet**

During the planning for this audit, we identified an error on the worksheet used to compute the additional child tax credit on a Spanish-language tax form.⁵ This form is used by residents of Puerto Rico to file their self-employment tax

⁴ We completed this test on December 20, 2001. At that time, revisions had been made to 31 of the 39 tax products. The scheduled completion date for most of the remaining eight tax products was January 31, 2002. We followed up on February 25, 2002, and determined that revisions were made to the remaining eight tax products.

⁵ The Spanish translation of Form 1040-PR is Planilla para la Declaración de la Contribución Federal sobre el Trabajo por Cuenta Propia (Incluyendo el Crédito Tributario Adicional por Hijos(as) para Residentes Bonafides de Puerto Rico).

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returns. The form indicated a \$100,000 modified adjusted gross income threshold for the married filing joint filing status, instead of \$110,000 as required by the EGTRRA 2001. While the worksheet properly reflected the increase in the child tax credit amount, the quality review process did not detect the error. Tax Forms and Publications Division personnel took immediate action to correct the error before the form was sent to the contractor for printing. If the error had not been corrected, taxpayers would have understated the amount they could claim in computing any additional child tax credit. During TY 2000, IRS records showed that approximately 62,000 taxpayers filed the Form 1040-PR.⁶

**Tools Used to Track Tax Law
Revisions to Tax Products Are
Incomplete**

Although the IRS is making changes to tax products to reflect the new tax law, the tools used to track the status of the changes are incomplete. We found:

- The tracking systems did not include all tax products.
- The tracking systems did not include key dates and other information for some tax products.

The tracking systems did not include all tax products

We identified 5 discrepancies when we compared 53 tax products used by individual taxpayers and listed on the IRS' Internet website to the 51 tax products used by individual taxpayers and listed on the LITS. For each of the five discrepancies, the tax product was either not listed on the LITS or was listed for only one of the provisions when both provisions affected the tax product. These tax products specifically mention income tax rates that required revisions as a result of the enactment of the new tax law. The five tax products were:

- Request for Federal Income Tax Withholding From Sick Pay (Form W-4S).
- U.S. Individual Income Tax Return (Form 1040A).
- U.S. Departing Alien Income Tax Return (Form 1040C).

⁶ We did not validate the reliability of the data in the IRS' records.

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- Armed Forces' Tax Guide (Publication 3).
- Earned Income Credit (Publication 596SP).⁷

IRS personnel in the Tax Forms and Publications Division agreed that two of the five tax products (Form 1040A and Publication 3) should have been included on the LITS for both provisions but were included for only one. However, we were told that the IRS never intended to include the remaining three tax products on the plan for the following reasons:

- Two tax products (Form W-4S and Form 1040C⁸) were finalized prior to the enactment of the EGTRRA 2001. Since these products affect a small number of taxpayers, the revisions will be made through either a news release or an announcement at a later date.
- The other tax product (Publication 596SP) is a Spanish translation of the English version of the publication. According to IRS personnel, tax products that are only Spanish translations of English tax products are not included on the LITS.

In addition, our analysis of the 39 tax products for revision status mentioned above showed the following:

- Twenty-five of the 39 tax products were not on the Tax Forms and Publications Division's Program Chart.
- Fifteen of the 39 tax products were not on the Multimedia Publishing Division's Milestones Production Schedule.

According to IRS personnel, their main goal is to make sure the tax products are revised. They assured us that the tracking systems would be updated. If the tax products are

⁷ The Spanish translation of Publication 596SP is Crédito Por Ingreso Del Trabajo.

⁸ Form 1040C affects both the rate reduction and child tax credit provision of the EGTRRA 2001. However, the form was included on the LITS for only the child tax credit provision.

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not included on the tracking systems, the IRS may not be able to effectively manage the revision process.

The tracking systems did not include key dates and other information for some tax products

The tracking systems used by the Tax Forms and Publications and Multimedia Publishing Divisions did not always show the targeted and actual completion dates for key steps in the tax product revision process. For example:

- Three of the 14 tax products on the Program Chart did not show critical completion dates, such as the date the product was reviewed or the date the section approved the product for printing. However, all three tax products had been revised to reflect appropriate changes from the EGTRRA 2001.
- Four of the 24 tax products on the Milestones Production Schedule had dates showing that the tax products were printed, but there were no dates showing the tax products had been approved.

As of December 19, 2001, the LITS showed that most of the tax products for the rate reduction and child tax credit provisions may not be completed by their scheduled completion dates. However, at the time of our review, 31 of the 39 tax products had already been revised to reflect the tax law changes. The “explanation” section of the LITS did not have any information showing why these tax products may not be completed by their scheduled completion dates.

Internal processes and government standards

As stated above, IRS employees are responsible for updating the tracking systems either monthly or as each key step in the revision process is completed. In addition, the General Accounting Office’s “Standards for Internal Control in the Federal Government” require pertinent information to be identified, captured, and distributed in a form and time period that permits people to perform their duties efficiently. The Standards also require transactions to be promptly recorded to maintain their relevance and value to management in controlling operations and making decisions. This applies to the entire process of a transaction

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or event from the initiation and authorization through its final classification in summary records.

Contributing factors

IRS personnel advised us that priority is given to making changes to tax products that reflect new tax laws rather than adding items to and updating the tools used to track the changes being made. These actions are taken due to the extremely short turnaround times that must be dealt with on new legislation. If there is a discrepancy on the tools, IRS personnel will revise or update the tools after the products are sent to printing contractors.

A prior TIGTA audit report⁹ indicated the IRS needed to strengthen its controls over the systems used to track the status of the tax forms development process. In response to that report, the IRS stated it would devote the necessary resources to ensure that internal controls are used to ensure the efficiency and effectiveness of the tax forms development process.

Without an accurate tracking system, the IRS will not have reliable information to ensure that tax products affected by new tax laws are identified, revised, and printed in time for the filing season.

⁹ *The Process of Developing Tax Forms for Individual Taxpayers Should Be Further Improved* (Reference Number 2000-40-060, dated March 2000).

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine if tax forms, instructions, and publications (tax products) for Tax Year 2001 reflect the tax law changes from the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA 2001).¹ We focused our tests on changes for the income tax rate reduction (rate reduction) and child tax credit provisions of the EGTRRA 2001.

To accomplish our objective, we performed the following tests:

- I. Determined if controls were adequate to ensure the accuracy and timeliness of revisions made to tax products.
 - A. Identified the process used to ensure revisions to tax products were accurately and timely made.
 - 1. Interviewed Tax Forms and Publications Division personnel and identified the process and the tools used to track revisions made to tax products.
 - 2. Obtained and reviewed the Operational Guidelines and Internal Revenue Manual procedures used by the Tax Forms and Publications Division.
 - B. Determined if tax products affected by the rate reduction and child tax credit provisions of the EGTRRA 2001 had been identified and revised.
 - 1. Obtained the Legislative Implementation Tracking System (LITS) for the EGTRRA 2001 as of November 7, 2001, and identified 51 tax products that are used by individual taxpayers² and were affected by the rate reduction and child tax credit provisions for Tax Year 2001.
 - 2. Obtained a list of tax products available to individual taxpayers from the Internal Revenue Service's (IRS) Internet website and identified 53 that were affected by the rate reduction and child tax credit provisions.
 - 3. Compared the 51 tax products identified on the LITS to the 53 identified on the IRS' Internet website to determine whether all the tax products affected by the rate reduction and/or the child tax credit provisions were included in the LITS as action items requiring revisions.
 - 4. Interviewed a manager in the Office of Tax Administration Coordination to determine the process for monitoring action items on the LITS.

¹ Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38 (2001).

² Individual taxpayers are non-business taxpayers who file United States Individual Income Tax Returns (Forms 1040, 1040A, or 1040EZ).

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5. Selected a judgmental sample of 39 tax products from a population of 77 tax products identified on the LITS for Tax Year 2001 as of November 7, 2001, for the rate reduction and child tax credit provisions. Reviewed the tax products to determine whether the required revisions were made.³ (This population of 77 tax products also includes the 51 tax products that are used by individual taxpayers mentioned in step I.B.1. We selected a judgmental sample rather than a statistically valid sample of tax products to review because the tax products were scheduled for revision on different dates during the year. Our sample included tax products that were scheduled for revision during our audit period.)
 6. Obtained the Tax Forms and Publications Division's Program Chart as of November 5, 2001, that showed target and actual completion dates for revisions made to 14 of the 39 sampled tax products mentioned in step I.B.5. The remaining 25 tax products were not on the Program Chart. Compared the actual completion dates with target completion dates to determine whether the revisions were being made according to scheduled time periods.
- II. Determined if controls were adequate to ensure tax products were ready for printing.
- A. Interviewed Multimedia Publishing Division personnel to determine specific roles, responsibilities, and processes for preparing tax products for printing. Specifically determined:
 1. How the "OK to print" dates were established.
 2. Tools used to track the printing of tax products.
 - B. Obtained a list of "OK to print" dates for the tax products affected by rate reduction and child tax credit provisions of the EGTRRA 2001.
 - C. Obtained the Multimedia Publishing Division's Milestones Production Schedule as of January 16, 2002, that showed target and actual completion dates for printing and shipping of 24 of the 39 sampled tax products mentioned in step I.B.5. The remaining 15 tax products were not on the Milestones Production Schedule. Compared the target completion dates with actual completion dates to determine whether printing efforts were meeting the scheduled time periods.

³ We completed this test on December 20, 2001. At that time, revisions had been made to 31 of the 39 tax products. The scheduled completion date for most of the remaining eight tax products was January 31, 2002. We followed up on February 25, 2002, and determined that revisions were made to the remaining eight tax products.

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Appendix II

Major Contributors to This Report

Michael R. Phillips, Assistant Inspector General for Audit (Wage and Investment Income Programs)

Kerry Kilpatrick, Director

Deborah Glover, Audit Manager

Dan Adams, Senior Auditor

Frank Jones, Senior Auditor

Jack Forbus, Auditor

Andrea Hayes, Auditor

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Appendix III

Report Distribution List

Commissioner N:C
Deputy Commissioner N:DC
Director, Customer Assistance, Relationships, and Education W:CAR
Director, Media and Publications W:CAR:MP
Director, Multimedia Publishing W:CAR:MP:M
Director, Tax Forms and Publications W:CAR:MP:FP
Chief Counsel CC
National Taxpayer Advocate TA
Director, Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O
Office of Management Controls N:CFO:F:M
Audit Liaison:
 Media and Publications Division W:CAR:MP

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Appendix IV

List of Tax Products That Were Reviewed

1	Form W-4V	Voluntary Withholding Request
2	Form 1040	United States (U.S.) Individual Income Tax Return
3	Form 1040A	U.S. Individual Income Tax Return
4	Form 1040C	U.S. Departing Alien Income Tax Return
5	Form 1040EZ	Income Tax Return for Single and Joint Filers With No Dependents
6	Form 1040NR	U.S. Nonresident Alien Income Tax Return
7	Form 1040-PR	Planiilla para la Declaración de la Contribución Federal sobre el Trabajo por Cuenta Propia (Incluyendo el Crédito Tributario Adicional por Hijos(as) para Residentes Bonafides de Puerto Rico)
8	Form 1040-SS	U.S. Self-Employment Tax Return (Including the Additional Child Tax Credit for Bona Fide Residents of Puerto Rico)
9	Form 1099-DIV	Dividends and Distributions
10	Form 1099-INT	Interest Income
11	Form 1099-OID	Original Issue Discount
12	Form 1116	Foreign Tax Credit (Individual, Estate, Trust, or Nonresident Alien Individual)
13	Form 2210	Underpayment of Estimated Tax by Individuals, Estates, and Trusts
14	Form 3800	General Business Credit
15	Form 5884	Work Opportunity Credit
16	Form 6765	Credit for Increasing Research Activities
17	Form 8586	Low-Income Housing Credit
18	Form 8805	Foreign Partner's Information Statement of Section 1446 Withholding Tax
19	Form 8814	Parents' Election to Report Child's Interest and Dividends
20	Form 8826	Disabled Access Credit

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21	Form 8835	Renewable Electricity Production Credit
22	Form 8846	Credit for Employer Social Security and Medicare Taxes on Certain Employee Tips
23	Form 8861	Welfare-to-Work Credit
24	Publication 15-T	New Withholding Tables for 2001 (For Wages Paid After June 30, 2001)
25	Publication 519	U.S. Tax Guide for Aliens
26	Publication 550	Investment Income and Expenses (Including Capital Gains and Losses)
27	Publication 554	Older Americans' Tax Guide
28	Publication 678	Volunteer Assistor's Guide, Student Text
29	Publication 919	How Do I Adjust My Tax Withholding?
30	Publication 972	Child Tax Credit (For Individuals Sent Here From the Instructions for Forms 1040, 1040A, and 8812)
31	Publication 1155	Volunteer Assistor's Guide, Instructor Text
32	Form W-9	Request for Taxpayer Identification Number and Certification
33	Form 1040 ES (NR)	U.S. Estimated Tax for Nonresident Alien Individuals
34	Form 1040NR-EZ	U.S. Income Tax Return for Certain Nonresident Aliens With No Dependents
35	Form 1041 ES	Estimated Income Tax for Estate and Trusts
36	Form 1042-S	Foreign Person's U.S. Source Income Subject to Withholding
37	Publication 3	Armed Forces' Tax Guide
38	Publication 505	Tax Withholding and Estimated Tax
39	Publication 553	Highlights of 2001 Tax Changes

NOTE: The last eight tax products listed in the chart above were revised in January 2002.

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Appendix V

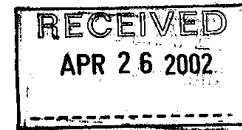
Management's Response to the Draft Report




COMMISSIONER
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

April 25, 2002



**MEMORANDUM FOR TREASURY INSPECTOR GENERAL FOR
TAX ADMINISTRATION**

FROM: John M. Dalrymple 
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report - Appropriate Changes Were Made to
Tax Products; However, Improvements are Needed for
Tracking the Changes (Audit # 200140050)

The task of analyzing the Economic Growth and Tax Relief Reconciliation Act of 2001 to accurately create and revise our tax forms, instructions, and publications on time was extremely challenging. Our dedicated and professional staff worked tirelessly to make the complex changes to our forms and publications transparent to the taxpayer. We appreciate your recognition that, given the time constraints, our first priority is ensuring the technical accuracy of our tax products.

Legislation enacted late in the product development cycle can be very challenging for us. However, we continue to seek ways to minimize the taxpayers' reporting burden and to improve tax forms and publications to make it easier for taxpayers to voluntarily comply with the laws. The new rate reduction credit and the changes to the child tax credit provisions affected millions of taxpayers. To help them understand how to complete the forms and worksheets to receive the benefits of these changes, we tried to make our forms changes and instructions as clear as possible.

Although the overall result of your audit was extremely favorable, your report noted we need to improve the tracking of changes we make to tax products. We agree with this finding and are taking steps to more closely monitor changes to tax products using our Legislative Implementation Tracking System and to update the status of those already in the system's database.

If you have any questions or wish to discuss the report with me, please call me at (202) 622-6860 or Carolyn Tavenner, Director, Media and Publications, at (202) 622-7602.